

**ADOPTED DECEMBER 20, 2001**

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
 ) No. 101519  
David and Marilee Duff )  
 )

### Representing the Parties:

For Appellants: Mike Steele, CPA

For Respondent: Suzanne L. Small, Tax Counsel

Counsel for Board of Equalization: Ian C. Foster, Graduate Legal Assistant  
Craig R. Shaltes, Tax Counsel III

## OPINION

This appeal is made pursuant to section 19324, subdivision (a),<sup>1</sup> of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of David and Marilee Duff for a refund of personal income tax penalties in the amount of \$5,232.98 for the year 1998. The issues on appeal are whether appellants have demonstrated reasonable cause to abate a late filing penalty, and whether appellants have shown that an underpayment of estimated tax penalty should be abated.

<sup>1</sup> Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the year in issue.

Facts and Contentions

Appellants established their principle residence in Massachusetts in October of 1996, and the parties do not dispute that appellant-husband remained a Massachusetts resident during all of 1998. Appellant-husband worked in California during 1998, earning \$251,466 in wages from Brook Furniture Retail, Inc. When appellants failed to file a California return by the due date, respondent sent a letter demanding that they file a return or explain why no return was required. Appellants then filed a 1998 nonresident return with which they remitted the balance due on May 24, 2000. Appellants did not claim a withholding credit because appellant-husband's employer did not withhold California state tax during 1998. Upon review of this return, respondent imposed a late filing penalty and an underpayment of estimated tax penalty. Appellants paid these penalties on June 27, 2000, and requested a refund. Respondent denied the request on December 5, 2000, and this timely appeal followed.

Appellants assert that appellant-husband's employer was required to withhold California state income tax but failed to do so. The employer apparently withheld only Massachusetts state income tax because appellant-husband used his Massachusetts address on his W-4 form. Appellants assert that it was the employer's responsibility to determine which state required withholding and to withhold accordingly. Appellants argue that the employer's failure to properly withhold caused their late filing and their failure to pay estimated tax.

Respondent argues that appellants had a non-delegable duty to file on time, and that their circumstances did not prevent timely filing. Therefore, according to respondent, the late filing penalty was proper. Respondent further argues that it was appellants' responsibility to make timely estimated tax payments, and that the law does not provide for abatement of the underpayment of estimated tax penalty in this case.

Late Filing Penalty

Individuals must file California income tax returns on or before April 15, or on or before the extended due date of October 15 following the tax year. (Rev. & Tax. Code, §§ 18566 & 18567.) Section 19131, subdivision (a), states in pertinent part:

"If any taxpayer fails to make and file a return required by this part on or before the due date of the return or the due date as extended by the Franchise Tax Board, then, unless it is shown that the failure is due to

reasonable cause and not due to willful neglect, [a penalty shall be imposed]."

To establish reasonable cause, the taxpayer "must show that the failure to file timely returns occurred despite the exercise of ordinary business care and prudence, or that cause existed as would prompt an ordinary intelligent and prudent businessman to have so acted under similar circumstances." (*Appeal of Howard G. and Mary Tons*, Cal. St. Bd. of Equal., Jan. 9, 1979.) The burden is on the taxpayer to prove that the difficulties experienced prevented him from filing a timely return. (*Appeal of Kerry and Cheryl James*, Cal. St. Bd. of Equal., Jan. 3, 1983.) Furthermore, ignorance of the filing requirement does not excuse the late filing penalty. (*Appeal of Diebold, Incorporated*, Cal. St. Bd. of Equal. Jan. 3, 1983.)

Appellant acknowledges having earned enough income while working in California during 1998 to be subject to the California income tax and its filing requirement. The fact that appellant's employer failed to properly withhold did not prevent appellant from filing his 1998 return by April 15, 1999, and appellant's alleged ignorance of the filing requirement cannot serve as an excuse. We therefore find that respondent properly imposed the late filing penalty.

#### Underpayment of Estimated Tax Penalty

Internal Revenue Code (IRC) section 6654, as incorporated by section 19136, imposes a penalty for a failure to timely pay the full amount of estimated tax. Section 19136, subdivision (g), provides that the penalty does apply to nonresidents. Respondent argues that this penalty cannot be abated, not even for reasonable cause. However, we direct respondent's attention to section 19136, subdivision (d)(2), which states in pertinent part:

"No addition to the tax shall be imposed under this section if any of the following applies:

"[(1)] – [(1)].

"(D) Eighty percent or more of the adjusted gross income for the taxable year consists of items subject to withholding pursuant to Section 18662 or 18666 of this code or Section 13020 of the Unemployment Insurance Code."

(Emphasis added.) Unemployment Insurance Code (UIC) section 13020 states in pertinent part:

“Every employer who pays wages . . . to a nonresident employee for services performed in this state, shall deduct and withhold from those wages, . . . , for each payroll period, a tax computed in that manner as to produce, so far as practicable, . . . a sum which is substantially equivalent to the amount of tax reasonably estimated to be due under Part 10 (commencing with Section 17001) of Division 2 of the Revenue and Taxation Code . . . .”

Appellant-husband’s entire adjusted gross income for 1998 appears to be wages from Brook Furniture Retail, Inc. Because appellant-husband worked temporarily in California and earned these wages from a California source, he and his employer should have known that there would be taxes due under Part 10 of Division 2 of the Revenue and Taxation Code.<sup>2</sup> (See Rev. & Tax. Code, § 17041, subd. (b).) UIC section 13020 states that employers “shall deduct and withhold” tax from such wages, thereby creating a clear withholding requirement in this case.<sup>3</sup> Thus the question before us is not whether appellant-husband’s employer ought to have withheld tax from the wages at issue, but whether appellant-husband’s wages were “subject to withholding” for purposes of section 19136, subdivision (d)(2)(D).

We note that the phrase “subject to withholding” may be ambiguous because in a vacuum it could reasonably be interpreted in two different manners. The phrase might refer to an employer’s actual withholding of taxes from the wages, or the phrase might refer only to the requirement than an employer withhold taxes. This possible ambiguity, however, is easily resolved by examining the language and purpose of section 19136, and we hold the latter interpretation to be more suitable.

First, looking to the language of section 19136 we find subparagraph (d)(2)(C), which provides an exemption from the penalty when 80 percent of the estimated tax “will be paid by withholding of tax.” Thus, there is already an exemption dealing with the actual withholding of tax, and subparagraph (d)(2)(D) would be redundant if it also referred to actual withholding. Further, if the phrase “subject to withholding” did refer to actual withholding, subparagraph (d)(2)(D) would carry little

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<sup>2</sup> Part 10 of Division 2 is also known as California’s Personal Income Tax Law.

<sup>3</sup> UIC section 13020 contains a number of exceptions that do not appear to apply to appellant’s wages. Respondent has not alleged that any of these exceptions apply to appellant’s wages, and the appeal record does not contain any information that appears to trigger these exceptions.

meaning. After all, if an employer actually withheld tax from the employee's wages then there is likely no underpayment upon which to impose a penalty, and thus no need for an exemption from the penalty. We will not interpret subparagraph (d)(2)(D) in a manner that renders it redundant or meaningless. Second, the clear purpose of section 19136 is to encourage taxpayers to pay tax throughout the year, thereby supplying the State with a steady revenue stream. This purpose would not be availed by penalizing individual taxpayers for an employer's failure to properly withhold. In this light, the more suitable interpretation of the phrase "subject to withholding" is that it refers only to the requirement that an employer withhold tax, and not to the actual withholding of tax.<sup>4</sup>

In this case, because appellant-husband's wages were "subject to withholding" by UIC section 13020, the section 19136 underpayment of estimated tax penalty does not apply. (Rev. & Tax. Code, § 19136, subd. (d)(2)(D).) Respondent's imposition of this penalty was therefore improper.

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<sup>4</sup> Our interpretation does not leave open the possibility of a taxpayer evading the section 19136 penalty through bad faith, because paragraph (d)(3) states that the exemptions to the penalty will not apply when the taxpayer obtains reduced withholding through fraud.

ORDER

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED, pursuant to section 19333 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of David and Marilee Duff for refund of personal income tax in the amount of \$5,232.98 for the year 1998 be and the same is hereby modified as follows: respondent's denial of the claim for refund of underpayment of estimated tax penalty is reversed; respondent's action in all other respects is sustained.

Done at Sacramento, California, this 20th day of December, 2001, by the State Board of Equalization, with Board Members Mr. Parrish, Mr. Klehs, Mr. Andal, Mr. Chaing and \*Ms. Marcy Jo Mandel present.

Claude Parrish , Chairman

Johan Klehs , Member

Dean Andal , Member

John Chiang , Member

\*Marcy Jo Mandel , Member

\*For Kathleen Connell per Government code section 7.9.

